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Financial Markets

Irving Trust

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The prices on government securities auctioned this week continued their decline, in part because the auctions were conducted in a very uncertain market environment. The sharp $5.6 billion surge in money supply last week caught most by surprise. It leaves M1 way over the top of its target--by about $20 billion. Those market participants who were (supposedly) "looking through" last week's M1 increase to declines this week are now looking at forecasts of much smaller declines than were expected before. This has further dampened market sentiment. Government securities dealers have been discouraged from taking positions by the prospect for continued uncertainty on the direction of Fed policy.

Some participants contend the Fed has tightened its policy. Others insist the Fed has done nothing. Clarification of this issue would help market performance greatly. However, because we have just passed a corporate tax payment date, and now mid-year is upon us, certain technical factors are in force that could--by themselves--keep the rate for Fed funds "excessively" high: The Fed typically does not accommodate extraordinary demands for funds at quarter-end or year-end. Thus, as the auctions occurred, securities dealers were undoubtedly aware that a seasonally strong funds rate was expected and would make it unlikely for a bond market rally to occur soon. The usual mid-year tightness will put off to the future any clarification of Fed policy (which now is taken to be the trading range for Fed funds).

My position in this debate on the Fed is that the Fed has already firmed its policy. The market now is suffering from an overdose of M1, and the Fed has decided to take a modest action. The Fed can no longer assert that the growth of M1 is merely technical. It is true that the fastest growing component of M1 is the other checkable deposits category that includes NOW and Super NOW accounts. This component has grown at a 38% rate over the past year; 60% over the last month. However, currency has also been growing rapidly, 9%-11% for most periods over the last year. More importantly, over the last month, demand deposits have increased their rate of growth from 4% to 18%. It's probably true that the fast growth of other checkables reflects a switch of funds from demand deposits to other checkables, possibly also some funds from other sources. However, the persistence of the growth of other checkables, coupled with the recent surge in demand deposits, makes it hard for the Fed to dismiss money growth for any reason.

The breadth of the M1 money growth problem is becoming apparent. At the same time, M3 hovers at the top of its target range. The economy is stronger, and if the second quarter strengthens beyond the "flash" estimate, the velocity of M1 might even rise. The Fed has missed (or seems to be missing) the last three M1 targets it has set. This has been justified by the continued abnormal behavior of M1's velocity. But should M1's velocity start to grow, particularly when M1 itself is growing so fast, the Fed would be hard pressed to ignore it. Right now, the odds must favor a further tightening by the Fed.

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Market Yields

	6/24/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	9.00	8.88	14.88
Repurchase Agreements	8.88	8.88	13.13
U.S. Treasury Issues			
Bills			
3 months	9.32	8.95	13.57
6 months	9.61	9.28	14.40
1 year	9.86	9.50	14.59
Coupons			
2 years	10.41	10.08	14.93
4 years	10.73	10.37	14.91
7 years	10.96	10.62	14.88
10 years	10.96	10.67	14.71
Long Bond	11.01	10.75	14.22
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.30	9.00	14.90
3 months	9.30	9.10	15.40
6 months	9.60	9.45	15.65
1 year	9.95	9.75	15.65
Banker's Acceptances			
1 month	9.24	8.99	14.80
3 months	9.42	9.15	15.40
6 months	9.64	9.45	15.70
Eurodollar Deposits			
1 month	9.63	9.38	15.75
2 months	9.75	9.44	16.13
3 months	9.75	9.50	16.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	9.02	14.62
1 month	9.33	9.19	14.88
3 months	9.34	9.21	15.25
Bank Holding Companies			
1 month	9.07	8.68	14.62
Dealer Placed:			
3 months	9.56	9.24	14.98
New AA Corporate Utility Bond	12.10	11.80	16.65
Tax Exempt			
6 month Project Notes	4.80	4.90	8.00
1 year AAA Bond	5.10	5.50	8.25
5 year AAA Bond	6.50	6.75	9.60
20 year AAA Bond	9.40	8.70	11.65

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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